



Senate Commerce, Science and Transportation Committee

Testimony of Peter Lowy

CEO Westfield America
Founding Chairman, e-Fairness Coalition

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Introduction

Good morning Mr. Chairman, Mr. Ranking Member and Distinguished Members of the Committee. Thank you for inviting me to discuss with you the issues surrounding Internet taxation and specifically whether Congress should extend the Internet Tax Freedom Act, and if so, what changes may be needed. I appreciate this opportunity and commend your efforts to include diverse views in the Senate's consideration of these important issues.

I am the CEO of Westfield America, which owns a portfolio of 39 super regional and regional shopping centers across the country. I am also the Founding Chairman of the e-Fairness Coalition, which includes brick-and-mortar and online retailers, realtors, retail and real estate associations, as well as publicly and privately owned shopping centers. The e-Fairness Coalition also includes high tech related companies such as Gateway and Vertical Net. Through these companies and associations our Coalition represents 1 in 5 American workers on this issue.

Let me be clear. The e-Fairness Coalition advocates a level playing field for sales and use tax collection for all retailers. We also support the continued growth of the Internet and do not support any form of discriminatory taxes or taxes on Internet access. However, the government should not provide preferential sales tax treatment based solely upon the distribution system used to sell goods. Requiring brick and mortar retailers to collect sales taxes while exempting their online competitors is fundamentally unfair, and presents a glaring national problem that requires

Congressional action. Therefore, equitable collection of the sales tax needs to be addressed concurrently with an extension of a moratorium on discriminatory taxes and taxes on Internet access.

Supreme Court Invites Congressional Action

In 1992, the Supreme Court ruled in *Quill v. North Dakota* (504 U.S. 298) that the Due Process Clause of the United States Constitution did not bar enforcement of the State's use tax if the vendor purposefully directed its activity toward the State, even if the vendor had no physical presence in the State. At the same time, however, the Court reaffirmed the Commerce Clause rule of *National Bellas Hess* that an out-of-state vendor must have a physical presence in the State in order to be required to collect use taxes on sales into the State. In the decision, the Court reasoned, "the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve." To date, the *Quill* decision's invitation for Congressional action has been unanswered.

Under *Quill*, the Court indicated that any further refinements of the Commerce Clause rule of physical presence must emanate from Congress in light of its authority to "regulate Commerce with foreign Nations, and among the several States." Justice Stevens addressed this in his opinion in *Quill*:

"No matter how we evaluate the burdens that use taxes impose on interstate commerce, Congress remains free to disagree with our conclusions. See *Prudential Insurance Co. v. Benjamin*, 328 U.S. 408 (1946). Indeed, in recent years Congress has considered legislation that would "overrule" the *Bellas Hess* rule. Its decision not to take action in this direction may, of course, have been dictated by respect for our holding in *Bellas Hess* that the Due Process Clause prohibits States from imposing such taxes, but today we have put that problem to rest. Accordingly,

Congress is now free to decide whether, when, and to what extent the States may burden interstate mail-order concerns with a duty to collect use taxes.”

Therefore, the e-Fairness Coalition urges Congress to use its Commerce Clause authority, to which the Supreme Court emphatically deferred, to assist states by enacting federal legislation to ensure a level playing field.

Need for a Level Playing Field

I believe we must have a level playing field for three reasons: (1) the current sales tax system is broken – it simply does not work in the “clicks and bricks” environment; (2) equity or “fairness”; and (3) states rights – that is the rights of states to set their own tax policy.

Closing the Loophole: The Current Consumption Tax System is Broken

The most urgent issue facing the Senate is the viability of the current consumption tax system. No longer are we looking at catalog sellers who owned a small percentage of the marketplace, we are discussing the ability of States to maintain their revenues and to provide needed services within the current system. The General Accounting Office (GAO) estimated in June 2000 that state and local revenue losses from remote sales could be as much as \$20 billion by 2003.

The current sales tax system does not work in today’s competitive business environment. Due to market realities, brick-and-mortar retailers are forced to respond to their online, tax-free competitors by setting up their online stores as separate subsidiaries. This corporate structure allows the online store to avoid physical nexus rules and the corresponding sales tax collection responsibilities. These “dot.com” subsidiaries only collect sales taxes in states where they have a

warehouse or a headquarters. For example, K-Mart's online store, bluelight.com, only collects sales taxes in California and Ohio; Barnes and Noble.com only collects in New Jersey, Nevada, New York, Tennessee and Virginia; Wal-Mart.com only collects in Arkansas, California, Ohio and Utah. As long as this system is in place, more and more retailers will do the same.

I have attached two items, which discuss this very subject. The first, an E-Commerce Tax Alert article from March 2000, describes how to set up a subsidiary to avoid sales tax collection responsibilities. The article states that, "Internet tax headaches and the accompanying competitive disadvantages may be avoided by setting up a nexus-breaking subsidiary to shield transactions from sales tax collection duties in all but a few instances." The second attachment is drawn from the www.thewebstoreguide.com. That piece outlines for consumers how to avoid paying sales tax and also refers to the growing practice of setting up separate Internet entities "just to avoid having to charge customers sales tax."

Another tactic currently employed by a number of retailers is the installation of kiosks with Internet terminals in their physical stores. A customer can today enter the store, sample or try on the merchandise, have the sales person order the merchandise over the Internet, and have it delivered to the consumer and avoid charging and collecting the sales tax. While the law is still unclear on this issue, it is possible that a consumer may also purchase goods on the Internet and then return those items to a physical store. Those retailers may argue that this would not establish nexus as the Internet business has contracted with the physical store to accept returns. As more and more retailers place internet kiosks in their physical stores, States will have to rely on the consumer to voluntarily pay the use tax owed, devise a system to track the sale or delivery

of remote sales, or forego the sales tax. This, I believe, is the major risk that Internet retailing presents for state and local revenues.

However, I would like to note that most of the country's largest retailers, who -- in order to compete in the Internet economy-- are forming these subsidiaries under the current law, would rather not be forced to do so. In fact, many are members of the e-Fairness Coalition. They recognize that the current consumption tax system is inequitable and support providing a level playing field for all retailers. The nation's largest on-line retailers, such as Wal-Mart, are also the nation's largest physical retailers – and they are willing to forsake short-term advantages for a collection system that is fair for all.

Since even in-store sales can now be set-up to avoid sales tax collection, the question is no longer whether pure Internet sellers should collect sales taxes; the question is where will states go to make up for the loss of revenue due to the explosion of the dot.com subsidiary. Will it be increased personal or commercial property taxes – or will states cut funds for education, police, and roads?

Fairness in the Consumption Tax System

The issue of equity – or “fairness “ is not a question of whether there should be a consumption tax on goods and services, but rather, if a state chooses to have a consumption tax, should it be implemented equally. Simply put, there is no logical argument that supports taxing the same retail transaction differently depending on the delivery system. The market place should determine sales decisions, not discriminatory tax policies.

It is bad policy and bad economics to have a tax policy that favors one group of businesses over another when both groups are selling the same products to the same consumers into the same localities. Tax policy should not distort the free enterprise system by picking winners and losers in the marketplace. Consumers should make their buying decisions based on price, availability, service and convenience. They should not be influenced by discriminatory tax policy.

States Rights

The States, and not the federal government, should have the right to impose, or not impose, consumption taxes as they see fit. The reality is that education and other essential services are funded largely by the States, especially through sales taxes. Passing an extension of the moratorium without taking steps toward a comprehensive solution would send a clear signal to the states that Congress is willing to ignore a major, national inequity in order to provide some businesses with preferential tax treatment. This would halt the substantial progress the states have made in simplifying and unifying their sales tax systems, and may force states to consider raising property or income taxes to make up for the lost revenues.

I firmly believe that Congress should allow states to require all remote sellers to collect and remit sales taxes on deliveries in that state provided that states and localities dramatically simplify their sales and use tax systems. Simply put, remote retailers – that is Internet and catalog retailers – should be subject to the same sales tax collection responsibilities as traditional or Main Street retailers, if the states are successful in simplifying their sales tax systems. Once the states

simplify, thereby lifting administrative burdens off of retailers, there is no reason to provide remote sellers with an exemption from collecting sales taxes.

The e-Fairness Coalition believes that states should have the right to either opt in – or not opt in – to a compact that would require simplification and decide for themselves whether or not to require collection. If a Governor of a state believes that remote sellers should be exempt from having to collect use taxes – they will maintain their right to not collect taxes. However, if another state chooses to require collection and meets simplification criteria set out by the Congress, that state should be given the mandate to require collection. Further, if a state does not currently collect sales tax, they would not be required to do so. Pure and simple, this is an issue of federalism and of states’ rights.

Support for the “Internet Tax Moratorium and Equity Act”

That is why the e-Fairness Coalition supports a comprehensive solution to this issue. We support the “Internet Tax Moratorium and Equity Act,” which was introduced last week by Senators Dorgan, Enzi, Breaux, Chafee, Durbin, Hutchison, Graham, Lincoln, Rockefeller, Thomas, and Voinovich. This legislation will (1) promote the continued growth of the Internet and (2) will allow states to ultimately require that remote sellers collect and transmit sales and use taxes just as traditional retailers do today.

I would also like to note that the “Internet Tax Moratorium and Equity Act” promotes the growth of Internet-related entities through such provisions as an exemption from use tax collection requirements for remote sellers falling below a de minimus threshold of \$5 million in gross

annual sales; reasonable compensation for tax collection by sellers; and uniform audit procedures.

Opposition to S. 288

The e-Fairness Coalition opposes the language found in S. 288, introduced by Senators Wyden and Leahy. Our opposition to this bill is based on a number of specific factors, the most basic of which is that this bill would impose unreasonable burdens on the states during the simplification process without ultimately providing them with the authority to require that remote sellers collect sales taxes.

Section 4(b)(1)(B) of the Wyden bill requires uniformity among all states “in which a seller is located or does business.” In other words, under the Wyden bill, no state could require a seller to collect use taxes if any single state in which that seller “is located or does business” had a dissimilar “tax, procedure, standard, or system.” Thus, for any state to institute a comprehensive collection system, uniformity would be required in all 50 states. Any requirement that all, or almost all, the states adopt uniform measures as an initial threshold before any collection authority is granted is unduly onerous and will likely never be met.

Second, unlike the Internet Tax Moratorium and Equity Act, S. 288 requires any “simplified sales and use tax system for remote sales” to have a single statewide rate for all sales subject to use tax. While the Coalition may ultimately agree to support legislation (such as S. 2775 introduced in the 106th Congress) that includes one use tax rate per state, we do not deem it

necessary to limit states to one rate per state as a prerequisite to a grant of authority to require collection by remote sellers.

Third, the E-Fairness Coalition considers it absolutely essential that states be given some assurance that if they enact extensive sales and use tax simplifications specified by Congress, they will receive authority to require remote sellers to collect use taxes. Without at least the “sense of the Congress” that compliance with Congressional criteria should result in the grant of such authority, state lawmakers will have great difficulty enacting any meaningful simplification. There is no such assurance in the Wyden bill. This means that under the Wyden bill, states would have less incentive to enact controversial simplification measures. Proponents of simplification may have difficulty getting such measures passed by state legislatures when critics would complain that simplification and conformity with federal guidelines might well go entirely unrewarded.

Fourth, the Wyden bill would expressly preclude the overruling of *Quill corp. v. North Dakota*. Section 5(a) reserves to the Congress the exclusive authority to change existing nexus law for the collection of sales and use taxes. This provision would be effective even if Congress did not grant any collection authority over remote sales. It would therefore freeze current nexus law with no chance of redress in the Supreme Court, even if the states simplified their sales and use tax systems to the point that the Court might otherwise find that they did not burden interstate commerce.

Finally, we oppose S. 288 because the Wyden bill includes a provision regarding business activity taxes -- an issue that is not addressed in the current Dorgan, Enzi et al bill. The e-Fairness Coalition does not believe that restrictions on the application of business activity taxes should be imposed as a precondition to a grant of broader collection authority for sales and use taxes. These two issues are unrelated and should not be linked together. S. 288 would require as part of any "simplified sales and use tax system for remote sales" a restriction that is not related to sales and use taxes: a nexus standard for corporate income taxes and similar levies that is significantly narrower than the existing standard. The Wyden bill would exempt businesses from any business activity taxes in states where they do not own or lease property or have employees or agents more than 30 days a year. If this provision were applicable, it would almost certainly force many states to choose between continuing to lose use tax revenues and giving up a portion of the business activity taxes that they are currently collecting. It would be extremely unfortunate to create a situation where states that are willing to simplify their sales and use taxes are discouraged from doing so because of the possible curtailment of their ability to collect corporate income and franchise taxes.

Thank you for the opportunity to provide input on these important policy questions. I look forward to continuing to work with you to provide an equitable and streamlined sales tax collection system and I welcome any questions you may have for me today.

Features:

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Please click anywhere on the screen below and use the browser's print function to print the document.

Separate incorporation for e-commerce boosts tax planning strategies

As more established companies move on to the Internet, competitiveness with smaller dot-com operations creates questions over how to avoid sales and use tax nexus and keep the playing field level. While most large companies have nexus nationwide, small web-based upstarts often carefully choose where they locate with avoiding nexus in mind.

How can your company meet this challenge? Some experts advocate having an affiliate conduct your e-commerce operations. It sounds radical, but it represents solid tax-planning advice for some companies selling goods on the web. Internet tax headaches and the accompanying competitive disadvantages may be avoided by setting up a nexus-breaking subsidiary to shield transactions from sales tax collection duties in all but a few instances.

Perhaps the next memo you write should be addressed to those in charge of your company's electronic sales operation. Before they start selling, explore the possibility of creating a new subsidiary or affiliate to handle Internet sales and separate those sales from the nexus-creating activity your company already conducts.

Learn by example

Traditional businesses can learn from upstart cyberspace operations, which offer the convenience of shopping online and not collecting sales tax, suggests Jeremiah Lynch, a partner with Ernst & Young LLP in New York. Just as mail-order sellers avoid collecting sales or use taxes in most states, companies that rely on the Internet instead of a sales staff establish nexus only in states where they have offices, staff or property.

While brick and mortar businesses race to set up electronic commerce operations, many don't realize that a traditional structure establishes nexus for online transactions as well. Lynch says they miss an opportunity to reduce the number of states in which they must collect tax.

Just as companies once limited nexus through mail-order affiliates (Saks Holdings Inc., for example, set up Folio to handle its mail-order sales), they can establish affiliates to handle electronic sales. Lynch says the tactic limits nexus-creating activities to traditional transactions and offers customers a lower overall price—a necessity in a world where smaller competitors are selling the same goods with no sales taxes applied.

Amazon.com founder Jeff Bezos has said many times that he chose Washington state because it would not account for a large number of sales, thus allowing the bookseller to avoid nexus in major markets

nationwide. When Amazon built an East Coast distribution center, it chose Delaware because that state has no sales tax.

Though Amazon's competitor, barnes-andnoble.com, was not created solely with tax considerations in mind, the online bookstore has nexus only in New Jersey, New York and Virginia, where it has a distribution center, its headquarters and its online site, respectively, explains Ben Boyd, vice president of communications for the online bookseller.

A competitive issue

Traditional companies must consider such factors because upstart competitors that sell exclusively on the Internet offer the same products without charging tax. Though consumers who purchase goods free of sales tax are supposed to remit use tax, most never do, and states rarely press the issue unless it involves business-to-business transactions.

If sales tax is a competitive issue for booksellers, imagine the implications of purchasing large-ticket items tax-free. When an online customer faces the choice of purchasing a \$2,000 computer from a vendor who charges sales tax or one who doesn't, the decision is obvious, Lynch says.

Internet sales continue to climb, and whenever sales tax is a competitive issue, traditional retailers should at least consider setting up a separate affiliate for online transactions.

"Too many businesses are not taking advantage of this," Lynch says.

"There would be no reason not to form a separate company for electronic commerce."

Internet Sales Tax Guide

Ever wondered why only some online stores charge sales tax?

Never pay tax again! Simply follow these principles below to save!

- 1** If an Internet Store has a physical presence in the state that you are buying from, you will be charged that state's local sales tax.
- 2** If you buy from an internet store that isn't based in the state you are buying from, you will not be charged sales tax - great huh?
- 3** Even bricks and mortar stores count as a physical presence. Therefore it is much more likely that online sellers like Borders and Barnes&Noble will charge you sales tax because they have retail stores in most states
- 4** As a result of number 3, some companies are now even setting up separate internet divisions of there company, just to avoid having to charge customers sales tax. Good news for internet shoppers then!

Examples of taxing:

- 1** If you live in New York and buy from Bigwords.com, they do not have a physical presence in that state, so you won't be charged any sales tax.
- 2** If you live in New Jersey and buy from CDNOW, they have a physical presence in that state so they will charge you New Jersey's sales tax - currently 3 percent.

TheWebStoreGuide Sales Tax Advice

Take a look at the table below to see whether you will be charged sales tax, as this can save you extra dollars. This is especially true when the product you want to purchase costs the same price in more than one online store - pick the store that won't charge you sales tax. Or buy from 800.com, they are based in *Oregon which has no sales tax!*
Tough luck if you live in California - its the worst state to live in for being taxed in - many online stores have a physical presence there! Basically, if you buy from a store that has a presence in the same state as you, you will always pay the local sales tax.

List of Stores and Where They Charge Sales Tax

Online Store (Click to Read Review)	States tax charged in	Comments
Amazon	WA	-
Barnes&Noble.com	TN, NJ, NY, VA	Separate online business
Bigstar.com	MN, NY, CA, NV	-
Borders.com	MI, TN	-
Buy.com	CA, TN, MA, IN	Many distribution centers
CDNOW	CA, PA, FL, NY, NJ	Many distribution centers
CD Universe	CT	-
Drugstore.com	WA	-
E-Toys	CA	-
Outpost.com	CT, OH	-
Petopia.com	CA, MN, OH, IL, NY, NJ, TN	Many distribution centers
VarsityBooks		
800.com	OR	Oregon has no sales tax!

Members of the e-Fairness Coalition include:

Alabama Retail Association
American Booksellers Association
American Jewelers Association
Ames Department Stores
Atlantic Independent Booksellers Association
CBL & Associates Properties, Inc.
Circuit City Stores, Inc.
Electronic Commerce Association
First Washington Realty Trust, Inc.
Florida Retail Federation
Gateway Companies, Inc.
General Growth Properties, Inc.
Georgia Retail Association
Great Lakes Booksellers Association
Home Depot
Illinois Retail Merchants Association
International Council of Shopping Centers (ICSC)
International Mass Retail Association (IMRA)
Kentucky Retail Association
Kimco Realty Corporation
K-Mart Corporation
Lowe's Corporation, Inc.
The Macerich Company
Michigan Retailers Association
Mid-South Booksellers Association
Missouri Retailers Association
Mountains & Plains Booksellers Association
National Association of College Stores
National Association of Convenience Stores
National Association of Industrial and Office Properties (NAIOP)
National Association of Real Estate Investment Trusts (NAREIT)
National Association of Realtors (NAR)
National Community Pharmacists Association
National Retail Federation
New England Booksellers Association
Newspaper Association of America
North American Retail Dealers Association
Northern California Independent Booksellers

Pacific Northwest Booksellers Association
Performance Warehouse Association
RadioShack Corporation
Regency Realty Corporation
Retailers Association of Massachusetts (RAM)
ShopKo
Simon Property Group
Southeast Booksellers Association
Southern California Booksellers Association
South Carolina Merchants Association (SCMA)
Target, Inc.
Taubman Centers, Inc.
The Gap, Inc.
The Macerich Company
The Musicland Group, Inc.
The Real Estate Roundtable
The Rouse Company
Variety Wholesalers
VerticalNet, Inc.
Virginia Retail Merchants Association
Wal-Mart
Weingarten Realty Investors
Westfield America, Inc.
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